

Stretch IRAs

Too Much of a “Stretch” for You?

Investor Alert

Individual Retirement Accounts (IRAs) have been extremely popular as retirement vehicles for the past generation of investors. The tax-deferred savings for retirement has been described as the best tax break available to middle-class Americans. In response to recent IRS rule changes, a new variation on the traditional IRA – "stretch" IRAs - offers potentially huge payoffs that will be difficult for most investors to get.

What is a Stretch IRA?

A stretch IRA stretches the period of tax-deferred earnings of assets within an IRA beyond the lifetime of the person who established the IRA, typically over multiple generations. In other words, they would allow you to pass your IRA down several generations. Because there is so much time for investments in the IRAs to grow at a compounded, tax-deferred rate, the potential payouts are sometimes portrayed to be multi-million dollar amounts.

The potential income stream of the stretch IRA is based on IRS guidelines that include the life expectancies of the various beneficiaries. The amount of retirement money these plans generate depends on the rate of return of the underlying investment that funds the account and the length of time the money is invested. Typical underlying investments include mutual funds, variable annuities, individual stocks and bonds.

Sales presentations for stretch IRAs usually include value tables that give hypothetical examples showing how much the IRA account will be worth over time, sometimes for periods of up to 90 years.

It's All in the Assumptions

When considering a stretch IRA, you should know that the huge values that you see depend on the assumptions used. Any change in the assumptions can greatly reduce the projected value of the IRA.

You have to be careful because some of the assumptions used in the examples may not be stated in the tables. Furthermore, some of those assumptions likely will not be very realistic for your situation.

Protecting Yourself

You need to protect yourself when you are considering a stretch IRA. The following are some of the assumptions that may be contained in stretch IRA illustrations. If these assumptions do not fit your situation, you could make significantly less on your IRA than your salesperson's examples show you.

- **No need for the IRA money.** Some stretch IRA examples assume that you will have no need for the money in the IRA, either before or after retirement.
- **Taking the least money from the IRA, at the latest time.** Most stretch IRA examples assume you will take the smallest amount of money from the IRA the law allows, and at the latest time it allows without penalty, which is beginning at age 70 ½.
- **Beneficiaries die early.** Most stretch IRA examples assume that the beneficiaries of the IRA are assumed to die before reaching their full life expectancy, so that the money that they do not receive passes on to the next beneficiary.
- **Tax laws do not change.** Stretch IRA examples frequently assume that tax laws and IRS rules will remain constant for the life of the IRA.
- **No inflation.** Stretch IRA examples usually do not incorporate inflation, which will erode the purchasing power of your investment.
- **Returns don't vary.** Stretch IRA examples assume that the rate of return on the underlying investment will be constant and can be projected accurately over the long term, in spite of the fact that the underlying securities in the account involve various risks that cannot be predicted.

If the assumptions in the stretch IRA you are considering don't make sense for you, you need to ask the salesperson to use assumptions that are realistic for you and see if the new projected return meets your goals.

MONEY SCHOOL
Montana State Auditor's Office
Securities Department
840 Helena Ave.
Helena, MT 59601
(406) 444-2040
1-800-332-6148
<http://sao.state.mt.us>

Source: National Association of Securities Dealers (8/10/01)